IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945.

Estate of HUMPHREY J. LYNCH, deceased, THE COUNTY TRUST COMPANY and MARY A. FLEMING, Executors,

Petitioners,

against

THE COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 150 Fed. (2d) 747.

Jurisdiction.

The grounds for jurisdiction are:

1. The judgment of the Circuit Court of Appeals for the Second Circuit was filed on August 7th, 1945.

2. The judgment was rendered in proceedings to review an order of the Tax Court of the United States.

3. Jurisdiction is invoked under section 1141a of the Internal Revenue Code and section 240 of the Judicial Code.

Specification of Errors.

The errors which petitioner will urge if the writ of certiorari is granted are that the Circuit Court of Appeals for the Second Circuit erred in holding:

1. That the assignment by the Misses Lynch to decedent, dated November 18, 1931, given and accepted in payment of fees due decedent, was not income to the decedent in the year received, 1931, within the meaning of section 22a of the Revenue Act of 1928.

2. That the pendency of appeals from the Surrogate's decree of October 30th, 1931 prevented said assignment from being income to decedent in 1931 within the meaning of the Revenue Act of 1928.

3. That said assignment when given in 1931 and to the time of decedent's death on January 24th, 1938 was not property within the meaning of the Revenue Act of 1928, and specifically section 22a thereof.

4. That the sum of $5000 owing upon said assignment was includible in decedent's taxable income for the period in 1938 ending with decedent's death on January 24th, 1938, under section 42 of the Revenue Act of 1938.

Statutes and Regulations Involved.

Section 22a of the Revenue Act of 1928:

"Sec. 22. Gross Income.

(a) General definition—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, voca-

tions, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *".

Section 275 (a) of the Revenue Act of 1928:

"General Rule. The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period."

Section 42 of the Revenue Act of 1938:

"Sec. 42. Period in which Items of Gross Income Included.
The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period."

Article 53 of Treasury Regulation 74, applicable to the 1928 Act:

"Art. 53. Compensation paid other than in cash.—Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. * * *"

SUMMARY OF ARGUMENT.

POINT I.

Under section 22a of the Revenue Act of 1928 the assignment was income to decedent in 1931.

POINT II.

Upon the conceded facts, section 42 of the Revenue Act, both in purpose and by its terms, was inapplicable.

ARGUMENT.

POINT I.

Under section 22a of the Revenue Act of 1928 the assignment was income to decedent in 1931.

The provision of section 22a of the Revenue Act of 1938 here material was originally enacted in section II (b) of the Act of October 3, 1913 (38 Stat. at Large, p. 114), and thereafter continued in every revenue act, being now contained in section 22a of the Internal Revenue Code. Since the continued use of this provision evidences a fixed and uniform policy of the Congress, its meaning is of primary importance in the administration of the income tax laws. The provision is that "gross income" should include

> "* * * compensation for personal service * * * of whatever kind and in whatever form paid or from professions * * *."

The question at issue is the meaning and scope of "of whatever kind and in whatever form paid."

The comprehensive character of this provision has long been settled by this Court.

Thus, in *Old Colony Trust Company v. Commissioner of Internal Revenue,* 279 U. S. 716, in holding that a direct payment by a corporation of the personal income taxes of its officers constituted taxable income to such officers, Chief Justice Taft said (p. 729):

> "The form of the payment is expressly declared to make no difference (§ 213, Revenue Act of 1918, chap. 18, 40 Stat. at L. 1065). It is therefore immaterial that the taxes were directly paid over to the government. The discharge by a third person of an obligation to him is equivalent to receipt by the person taxed."

In *Helvering v. Midland M. L. I. Co.,* 300 U. S. 216, this Court held that where, at the judicial sale under the judgment foreclosing its mortgage, the mortgagee bid the property in for the amount of the mortgage plus the accrued interest thereon, the interest was taxable income to the mortgagee reporting on a cash basis, Mr. Justice Brandeis saying (p. 222):

> "Confessedly no interest was received in cash. The company insists that none was received in property. * * * We cannot say that Congress did not intend to include in its definition a case like the present merely because the taxpayer received a credit rather than money or other tangible property. Compare Raybestos-Manhattan v. United States, 296 U. S. 60, 62, 64, 80 L. ed. 44, 46, 56 S. Ct. 63, 102 A. L. R. 111. A receipt of interest is taxable as income whether paid in cash or by a credit. Compare Old Colony Trust Co. v. Commissioner of Internal Revenue, 279 U. S. 716, 73 L. ed. 918, 49 S. Ct. 499; United States v. Boston & M. R. Co., 279 U. S. 732, 73 L. ed. 929, 49 S. Ct. 505. * * * The intent to use the full extent of power being clearly evident, we must not confine the legislation within narrow forms than the statutory language would indicate.

> Compare Irwin v. Gavit, 268 U. S. 161, 166, 69 L. ed. 897, 898, 45 St. Ct. 475; Helvering v. Stockholms Enskilda Bank, *supra* (293 U. S. 89, 79 L. ed. 215, 55 St. Ct. 50)."

He further said (p. 224):

> "Where the legal effect of a transaction fits the plain letter of the statute, the tax is held payable, unless there is clearly revealed in the Act itself or in its history a definite intention to exclude such transactions from the operation of its applicable language."

It cannot be and has not been disputed that, at bar, the legal effect of the acceptance of the assignment as payment of the fee discharged and extinguished the debt of the Misses Lynch for decedent's services. Accordingly, it cannot be gainsaid that the transaction fitted "the plain letter of the statute"; that compensation for personal services was paid in the form of property, viz., a portion of a chose in action, clearly property within the statutory limits "of whatever kind and in whatever form paid".

None of the reasons given by respondent or either of the courts below justified refusing to give effect to these forthright provisions of a plain and all-inclusive statute.

Thus, the Commissioner adopted (Record, p. 7) the expedient of ignoring the assignment, assuming that the original debt from the Misses Lynch was still owing. This ground necessarily fell with the finding of the Tax Court that the fee had in fact been paid in 1931 by the assignment.

The ground upon which the Tax Court sustained the deficiency was no less unsound since it interpolated into section 22a a proviso not thereby authorized. That ground was that the Tax Court was (p. 16):

"* * * unable to find that the assignment * * * had any market value in the year received or at any time prior to the death of decedent."

The Tax Court pointed to no provision of section 22a or any other section of the 1928 Act which established market value as an essential ingredient of taxable income. On the other hand, this Court in *Helvering v. Enright*, 312 U. S. 636, clearly held that the taxability of income was neither dependent on the certainty of its value nor avoided by difficulty of evaluation. That case involved the includibility under section 42 in the taxable income of a decedent for the period in which fell the date of his death, of the value of his interest in a law partnership. This Court held that however uncertain might be the value of that interest because of unfinished matters in various stages of completion, whether taken on a straight fee or contingent fee basis, all were includible as accrued income, clearly indicating that the problem of valuation was one which had no relevance to the question of taxability, saying (p. 645):

"The completion of the work in progress was necessary to fix the amount due but the right to payment for work ordinarily arises on partial performance. Accrued income under § 42 for uncompleted operations includes the value of the services rendered by the decedent, capable of approximate valuation whether based on the agreed compensation or on *quantum meruit*. The requirement of valuation comprehends the elements of collectibility. The items here meet these tests and are subject to accrual."

Thus, assuming that in the case at bar a problem of evaluation were presented, it would be entirely immaterial to the question of taxability.

However, no such problem of valuation was here ever present, in 1931 or at any time thereafter, because of the

explicit provisions of applicable Article 53 of Regulations 74 applying to the 1928 Act, quoted above, that in a case such as this where the amount of the fee had been fixed, "such price will be presumed to be the fair value of the compensation received". (In this connection, it may be appropriate to note that we respectfully differ with Judge Swan's construction of this provision (Record, p. 43). Bearing in mind that its usual operation is against a taxpayer, we think its correct meaning is that unless evidence establishes an actual, different value (as against uncertain value), the presumption controls).

Being unable to support the ground of the Tax Court, the Circuit Court of Appeals put its judgment upon two new grounds (a) that two decisions of this Court "require (d)" the ruling that the appeals from the decree upholding the basic claims prevented the partial assignment thereof from being taxable income, and (b) that the assignment was not property within the meaning of the income tax laws.

We think that a mere reading of the first of the cases cited in support of the first ground, *North American Oil v. Burnet,* 286 U. S. 417, is sufficient to show that the contrary was there held.

In that case, a receiver in 1917 paid to a corporation income which he had received in 1916 from the corporate property. The receiver made this payment pursuant to the decree dismissing the receivership suit. Appeals taken from the dismissal decree were not finally disposed of until 1922. If this Court had applied the principle laid down at bar by the Court below it would have held that the income was not taxable to the corporation until 1922. That

is precisely what this Court did not hold. It held that the income was taxable when received in 1917, and not in 1922, saying (p. 424):

> "The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. See Board v. Commissioner of Internal Revenue (C. C. A. 6th) 51 F. (2d) 73, 75, 76. Compare United States v. S. S. White Dental Mfg. Co., 274 U. S. 398, 403, 71 L. ed. 1120, 1123, 47 S. Ct. 598. If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. Compare Lucas v. American Code Co., 280 U. S. 445, 74 L. ed. 538, 67 A. L. R. 1010, 50 S. Ct. 202, *supra.*"

The other decision cited in support of the first ground (*U. S. v. Safety Car Heating Co.,* 297 U. S. 88) did not involve the question here at issue.

Two questions were there involved, (a) whether profits from patent infringements earned by the infringer prior to February 25th, 1913, the effective date of the first income tax act, were free of income tax to the owner of the patent where the patent was not sustained until July, 1915 and the profits themselves not determined until 1923, and (b) whether the owner was entitled to a capital loss based upon the difference between the capitalized value of the profits as of February, 1913 and the lesser amount finally received on account thereof in 1925.

This Court held that because the capital fact of infringement was not determined until 1915, the claim to profits lacked the certainty essential to entitle the taxpayer to the benefit of the exemption of income earned prior to the effective date of the Sixteenth Amendment.

The notion that the appeal of the McArdle estate destroyed all value in the assignment is of course not tenable. The assignment was not merely of the decree which upheld the original claims but of the claims themselves (Record, p. 28). While the appeal may have cast some doubt upon the full value of the claims, it was no more doubtful than the hazard of collection in the Enright case which this Court dismissed with a single sentence (p. 645):

> "The requirement of valuation comprehends the elements of collectibility."

The second ground of the Circuit Court of Appeals, that the assignment should not be "regarded as property within the meaning of the income tax law" is not supported by any reference to any section of that law. The apparent basis for the ruling was that, in decedent's hands, the claims against the McArdle estate should not be treated as "property of a different kind and subject to a different tax liability from the claims of his assigns".

If this were true, then property which is capital to an assignor could never be income to an assignee. Obviously, this cannot be correct. The determination of when property is income depends upon the consideration which caused its payment or delivery to the recipient, not upon its status in the hands of the payor. The Court below cites the case of a third party note as being income. Such a note might well be capital to the transferor yet, concededly, that fact would not prevent that same note from being income to

the transferee taking it as compensation for services. And insofar as the Court below differentiates such a note from the assignment here on the basis of possible negotiation in the market, it fell into the same error as the Tax Court.

Finally, in view of the explicit provision of Article 53 of Treasury Regulation 74 quoted above (p 11) under which the fixed fee charge of $5000 was constituted the value of the assignment, the reasons below based on alleged lack of market value lose all substance.

POINT II.

Upon the conceded facts, section 42 of the Revenue Act, both in purpose and by its terms, was inapplicable.

As this Court has said, the purpose of section 42 was to catch income to a decedent which otherwise would escape taxation.

> *Putnam v. Commissioner*, 323 U. S. p. ....; 89 L. Ed. 734, 736.

That purpose is inapplicable here since, as we have shown, the assignment was taxable to decedent in 1931. Quite obviously, section 42 was here invoked only to evade the Statute of Limitations against any 1931 assessment, prescribed by section 275 (a) of the 1928 Act.

> *cf.*, Estate of Letz, 45 B. T. A. 1011, 1017.

Moreover, section 42, by its terms, is here inapplicable for the further reason that if the assignment was not taxable in 1931, it surely was taxable in 1935 when decedent had the legal right to obtain $1839.50 on account of it (Record, p. 37). Certainly, this was "a prior period" to

that in which fell decedent's death, in which the assignment was "properly includible".

Conclusion.

For the foregoing reasons, it is submitted that this cause involves questions of primary importance in the interpretation and administration of the income tax laws which should be determined by this Court, justifying the issuance of a writ of certiorari.

Respectfully submitted,

WARNER PYNE,
MONROE J. CAHN,
Counsel for Petitioners.